

COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON OVERSIGHT

Hearing on IRS Operations and the 2014 Tax Filing Season

May 7, 2014

Questions for the Record

Ms. Jenkins

1. Following the U.S. Court of Appeals' rejection in February 2014 of the IRS's mandatory return preparer regulation program, I understand the IRS is now considering a voluntary credentialing program for tax return preparers.
 - a. Can you provide a general update on the return preparer program and the status of the voluntary credentialing program?

Response

The IRS continues to believe mandatory testing and continuing education for tax return preparers is necessary for improving the accuracy of return preparation, improved preparer competency and overall tax compliance. For this reason, we are hopeful that the Congress will support the legislative proposal in the President's Fiscal Year (FY) 2016 Budget to explicitly provide the Department of Treasury and the IRS the authority to regulate all paid return preparers. In the interim, we launched the Annual Filing Season Program (AFSP), a voluntary program designed to encourage uncredentialed tax return preparers to complete continuing education courses to improve their knowledge and understanding of federal tax law relevant to the preparation of federal tax returns. Return preparers with a valid preparer tax identification number (PTIN) for the 2015 filing season, who complete the required continuing education, including a six-hour annual federal tax refresher course, will be issued a "2015 Annual Filing Season Program – Record of Completion." The IRS has issued more than 40,000 Records of Completion for the 2015 filing season.

- b. In light of the court's rejection of the prior regulatory initiative, does the IRS intend to engage with stakeholders before it advances a new voluntary program?

Response

The IRS engaged with stakeholders before launching the new voluntary program. The Return Preparer Office held individual meetings with five national organizations and seven of the largest employers of tax return preparers to share the proposed Annual Filing Season Program (AFSP) concept and to solicit input. Additional meetings were held with the Commissioner and Deputy Commissioner for Services and Enforcement at the request of some stakeholder groups.

Stakeholder input was considered and incorporated, as appropriate, in the program requirements.

- c. Before implementing any voluntary system, do you intend to put your proposals out for public comment and hearings? If not, why not?

Response

We engaged the stakeholder community as described in the response to b. above, and adjusted the final program based on the input and feedback received. While we did not solicit comments through a formalized process, it is important to note that participation in the AFSP is voluntary, not mandatory. An individual may be a paid federal tax return preparer even if the individual does not participate in the AFSP.

2. Under the voluntary credentialing program the IRS is considering, would the IRS require competency tests and continuing education? If yes, would the IRS administer the tests and education itself or would it contract these tasks out to third parties?

Response

The AFSP is a continuing education program with all continuing education courses offered and administered by IRS-approved third-party providers. The AFSP includes an Annual Federal Tax Refresher course with a comprehension test that is required for the satisfactory completion of the course. This course and its comprehension test are also provided by IRS-approved providers. The AFSP does not include a basic competency test, like the former mandatory program. Revenue Procedure 2014-42, describes the requirements of the voluntary program in detail.

3. It is my understanding that the principal fraudulent scheme perpetrated by dishonest paid preparers involves a preparer changing the return after the taxpayer has signed the return to increase the refund amount and diverting the extra amount into a preparer controlled bank account. Given that preparers currently have to register for PTINs so they can be accounted for in the preparer community, is the additional certification primarily designed to defeat this fraud scheme or is it aimed at an alternative goal?

Response

The AFSP is primarily designed to improve the knowledge and understanding of federal tax law and filing season requirements for uncredentialed tax return preparers. It will not impede those preparers intent on defrauding the tax system. The IRS is taking numerous actions to reduce return preparer fraud and prevent improper refunds, as detailed in response to Mr. Marchant's inquiry on this issue (response to Marchant question 1.a.).

Mr. Marchant

1. We have seen numerous press releases from the IRS and the Department of Justice announcing that tax return preparers had been convicted, jailed, or shut down for fraudulent conduct. In one press release from April 15, the Department of Justice wrote: “In the past decade, the Tax Division has obtained injunctions against hundreds of fraudulent tax preparers.” Despite these injunctions against fraudulent tax return preparers, there continues to be alarming reports of the IRS sending out questionable refunds generated by fraudulent return preparers long after the IRS should have realized there was a problem. For example, there have been reports of thousands of checks being sent to the same address or direct deposited into the same bank account.
 - a. What additional steps is the IRS taking over the next year to increase its vigilance against return preparer fraud, to block improper refunds from going out, and to shut down or prosecute fraudulent preparers?

Response

The IRS has a number of efforts underway designed to reduce inaccurate and fraudulent returns submitted by paid preparers. These efforts include due diligence visits, preparer investigations, notices, and injunctions. In addition, the IRS sponsors educational programs covering both substantive tax law and the preparer’s obligations under Circular 230.

The IRS screens public complaints of return preparer misconduct and investigates the most egregious instances of return preparer misconduct. Abusive tax schemes promoted by return preparers are identified through data analytics and swiftly investigated. Those engaging in these schemes are subject to criminal prosecution and sanctions such as civil injunctions, penalties, and suspension or disbarment from representing taxpayers before IRS (for those covered under Circular 230) and participation in the IRS’s electronic filing program.

This year the IRS plans to conduct over 1600 enforcement visits to tax return preparers to monitor compliance with the earned income tax credit (EITC) due diligence requirements, the requirements for participation in the IRS’s certified acceptance agent program to assist taxpayers in obtaining an individual taxpayer identification number (ITIN), and the requirements for participating in the electronic filing program as an electronic return originator.

We continued to improve our fraud and identity theft identification and prevention program for the 2015 filing season. Our plans include the following:

- Beginning in January 2015, we will not deposit more than three tax refunds into a single bank account. Additional tax refunds directed to be deposited to the same bank account will be paid by mailing a paper check to the taxpayer. Data shows multiple refunds deposited to a single bank account is an indication of potential fraudulent or ID theft activity on the tax return because it is easy for the perpetrator to establish and retrieve direct deposits from a single account. We believe this will have a positive impact on our efforts to deter fraud and identity theft. Stakeholders such as the Department of the Treasury Bureau of the Fiscal Service, the Treasury Inspector General for Tax Administration (TIGTA), the banking industry, the practitioner community, and Congress have expressed strong support of this effort.
- We will use “Device ID” information to identify potential identity theft or fraud. The term “Device ID” refers to the unique serial number (or fingerprint) of the device (for example, computer, smart phone, or tablet), and will be incorporated into the software industry electronic tax filing programs. The unique Device ID will be transmitted by the software as part of the electronically filed return and will assist the IRS in identifying the source of fraudulent returns and enable the IRS to associate fraudulent returns that are filed from the same device.
- A unique Electronic Filing Identification Number (EFIN) is issued to each Authorized IRS e-file Provider participating in the IRS’s e-filing program. As in past years, the IRS will deactivate any EFIN if it is determined that an identity theft victim's name and Social Security Number (SSN) was used to obtain the EFIN or that the EFIN was used to file fraudulent or identity theft returns. The list of suspected or compromised EFINs can be adjusted throughout the filing season providing flexibility to incorporate new data, insights, and lessons learned. During the 2014 filing season, CI identified more than 500 EFINs for revocation based on a suspicion that the e-file Provider engaged in fraud or identity theft. Fraud and identity theft filters for the 2015 filing season have been enhanced so that returns that use a stolen EFIN will be stopped and worked through the identity theft process.
- We will continue to implement new fraud and identity theft screening filters to improve our ability to spot false returns before we process them and issue refunds. In addition to our filters, we have a specialized group of analysts who will continue to review returns for patterns and schemes. These analysts review characteristics that may not be instantly detectable by the fraud identity theft filters. Any patterns or schemes discovered are added to the fraud and identity theft filters.
- We will continue to conduct compliance activities as part of our EITC-focused paid preparer effort including: Field examiner audits of preparers to determine whether they are complying with preparer due diligence requirements designed to

reduce ineligible EITC claims; so-called “knock-and-talk visits” made by CI agents to preparers to educate them on EITC rules and due diligence requirements; and undercover shopping visits to return preparers suspected of engaging in fraud. For the 2015 filing season, 100 “knock-and-talk” visits are scheduled, some of which have already occurred.

- As in past years, the CI Scheme Development Centers analyze return information from to identify emerging return preparer schemes and quickly disseminate information to the field for review and investigation. In FY 2014 the CI Return Preparer Program had the following results:

Return Preparer Program Investigative Actions	FY 2014
Subject Criminal Investigations Initiated	305
Prosecution Recommendations	261
Indictments	230
Convictions	193
Conviction Rate	96.0%
Sentenced	183
Incarceration Rate	86.3%
Average Months to Serve	28
Publicity Rate	94.5%

The current budget situation is a significant obstacle to more effectively combatting identity theft and refund fraud. The IRS has been operating under very tight budget constraints for years. The FY 2015 appropriations provided \$10.9 billion for the bureau. This is almost \$350 million, or 3 percent, below FY 2014 enacted and results in total IRS funding that is more than \$1.2 billion below FY 2010 levels. The IRS has already reduced permanent staffing levels by 13,000 since 2010.

Several initiatives in the President’s FY 2016 Budget address aspects of preparer compliance, fraudulent refund claims, and assistance to victims of identity theft. These include:

- \$18.9 million to *Improve Up-Front Identification and Resolution of Identity Theft Returns*, which will expedite resolution of identity theft cases and improve efficiency in review and disposition of leads received from external sources.
- \$47.0 million for the Return Review Program (RRP) to provide IRS an integrated and unified system that enhances our capabilities to detect, resolve, and prevent criminal and civil tax noncompliance, including identity theft.

- \$82.2 million to provide additional staffing and advanced technologies to *Prevent Identity Theft and Refund Fraud*.
- \$24.6 million (within the *Increase Audit Coverage* initiative) for correspondence examination programs including identifying and addressing return preparers who file egregiously non-compliant ITIN returns, and expanding the Real-Time Preparer compliance program.
- \$7.2 million (within the *Pursue Employment Tax and Abusive Tax Schemes* initiative) to acquire network analysis tools to improve identification of patterns of noncompliance, which has been successfully tested to match identity theft cases to ghost preparer networks (among other compliance issues).
- \$4.3 million to *Ensure Ethical Standards of Conduct for Practitioners* subject to Circular 230 regulations.

2. Commissioner Koskinen, in your testimony in April before the Senate Finance Committee, you said:

“Although the majority of return preparers are competent and operate with the highest ethical standards, the Government Accountability Office (GAO), the Treasury Inspector General for Tax Administration (TIGTA), and the IRS’s own research all suggest that our tax system and a large number of taxpayers may be poorly served by return preparers who engage in fraud.”

Could fraudulent preparers be assisted in their fraud efforts by obtaining some type of an IRS “validation”? Please discuss your thoughts on this issue.

Response

All tax returns, regardless of preparation method, are subject to the same review processes that identify instances of fraud and identity theft (based on the return’s characteristics). Tax returns filed with a ‘validation’ item, such as a Preparer Tax Identification Number (PTIN) on returns submitted by a preparer, and an EFIN on returns prepared and submitted electronically, are no exception and also undergo review processes to detect fraud including:

- Filters to select tax returns as fraudulent or identity theft if they meet certain characteristics. These returns are stopped and subsequently processed through our Integrity and Verification Operations.
- Review of returns by a specialized group of analysts for patterns and schemes (in addition to our fraud and identity theft filters).
- Continual data analytics, with adjustments to filters and models as necessary.

The EFIN program also has safeguards including:

- EFINs are deactivated when it is determined that the EFIN was established using an identity theft or fraud victim's name and SSN or that the EFIN was used for filing fraudulent identity theft returns.
- Returns that share a compromised EFIN in 2015 will be stopped by the fraud and identity theft filters and worked through the Taxpayer Protection Program.
- We continue to use historical characteristics from confirmed fraud and identity theft returns to protect taxpayers and revenue including EFINs with a significantly high percentage of identity theft in the prior year.

The current PTIN requirement gives the IRS an important and better line of sight into the return preparer community than ever before. PTINs allow the IRS to collect more accurate data on who is preparing returns, the volume and types of returns being prepared and the qualifications of those doing return preparation. Thus, the information obtained through the PTIN process helps us do more to analyze trends and spot anomalies, so that we have a much better understanding of the return preparer community as a whole, and can design appropriate compliance and educational activities in response to the data we collect.

While the preparer PTIN registration requirement is an important advance in our ability to ensure that all return preparers provide the proper level of service to taxpayers, the testing and continuing education components of our return preparer efforts are critical to making even more progress in this area. We continue to believe that the regulation of paid return preparers is important for the proper functioning of the U.S. tax system. Congress can help us further enhance our efforts to reduce tax return preparer-related refund fraud by enacting the following legislative proposals contained in the Administration's FY 2016 Budget:

Authority to regulate return preparers. The Administration's proposal would explicitly authorize the IRS to regulate all paid preparers. The regulation of all paid preparers, in conjunction with diligent enforcement, will help promote high quality services from tax return preparers, improve voluntary compliance, and foster taxpayer confidence in the fairness of the tax system. Incompetent and dishonest return preparers increase collection costs, reduce revenues, disadvantage taxpayers by potentially subjecting them to penalties and interest as a result of incorrect returns, and undermine confidence in the tax system.

Increase the preparer penalty for willful and reckless understatements. The Administration's proposal would increase the penalty imposed on paid preparers in cases of willful or reckless understatements to the greater of \$5,000 or 75 percent of the income derived by the preparer to more effectively discourage willful and reckless behavior by paid preparers.

Extend preparer due diligence to the child tax credit. The Administration's proposal would extend the preparer due diligence requirements that currently apply with respect to returns claiming the EITC to returns claiming the child tax credit (CTC) and the additional child tax credit (ACTC). Extending the due diligence requirement to the CTC and ACTC, which share many eligibility criteria with the EITC, could improve

compliance without excessively increasing the level of burden on paid preparers or taxpayers.

Mr. Paulsen

I have long been concerned about a potential IRS “real time tax system” in which the IRS would send a taxpayer a pre-filled tax return for their signature. Such a system could be costly, inefficient, and would set up the IRS to be both the tax collector and taxpayer.

The IRS has denied building this system in the past, but last year Acting Commissioner Werfel admitted that the IRS spent approximately \$4 million on the system. Some have estimated that actual spending on the program could be as high as \$30 million. This is despite repeated report language in the Financial Services Appropriations Bill stating that the IRS should not spend any money on this program.

I was very encouraged by your testimony before the House Financial Services Committee in February, during which you stated that you do not intend to have the IRS construct a “ready return” or bill presentment system. However, you hedged a little bit in your testimony saying that “real time tax system” was a “confusing term,” and that the IRS was only working on back-end processing systems.

I was then additionally confused by your testimony last week before the Senate Financial Services Appropriations Subcommittee where you requested budget authority for accelerated W-2 information reporting. It is my recollection that “accelerated tax reporting information” was actually part of the plan to build the real time tax system, including a “ready return bill presentment tax preparation” system.

1. Please provide detail on these back-end processing systems including how much the IRS has spent on them to date.
2. Is one of the key pieces of a real time tax system IRS receipt of accelerated W-2, 1099, SSA, and small business information?
3. Why have you conveyed conflicting messages to the House and the Senate? First, you testified before the House that the IRS wasn’t working on a real time tax system, but that you are building back-end processing systems. Then you requested Senate budget authority to accelerate W-2 information reporting but didn’t request the same of the House. Any clarity you can provide would be much appreciated.

Response Questions 1-3:

The IRS is not pursuing and has no plans to implement a “real time tax” system to create pre-filled forms or software/products for simple tax return or “ready return bill presentment” preparation.

There has been some confusion about the term “real time tax”, which was an IRS exploratory effort that has concluded. During 2011-2013, the IRS explored ways to improve the tax filing process through earlier and more intelligent matching of available data, such as third-party information returns, to income tax returns filed by taxpayers. These activities complied with the U.S. House of Representatives Committee on Appropriations statement (House Report 112-550) that prohibits the IRS from pursuing a simple tax return program.

Challenges with refund fraud and identity theft have led the IRS to advocate for earlier filing of information return documents in support of the Treasury Department’s Fiscal Year 2015 Revenue Proposal (Green Book) “Rationalize Tax Return Filing Due Dates So They Are Staggered” (page 246)

<http://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2015.pdf>. This proposal would greatly enhance our ability to identify mismatches earlier in the process, and thus, do a better job of stopping improper payments.

Accelerated information reporting (such as a Forms W-2 and 1099) provides authoritative source data against which the IRS can verify and validate income claimed on a filed return. These information return documents serve an important role in preventing tax return-based identity theft and fraud. Without information reporting documents, return verification is more difficult.

Under current law, most information returns, including Forms 1099 and 1098, must be filed with the IRS by February 28 of the year following the year for which the information is being reported, and Form W-2, Wage and Tax Statement, must be filed with the Social Security Administration (SSA) (or in some cases the IRS) by the last day of February. The due date for filing information returns with the IRS or SSA is generally extended until March 31 if the returns are filed electronically.

The Administration’s proposal would accelerate the filing due date by requiring information returns to be filed with the IRS (or SSA, in the case of Form W-2) by January 31, except that Form 1099-B would have to be filed with the IRS by February 15. The proposal would also eliminate the extended due date for electronically filed returns. As you mentioned, this was included in my written testimony from this hearing on May 7, 2014 (see page 14):

http://waysandmeans.house.gov/uploadedfiles/irs_testimony_050714os.pdf.

In addition, the Government Accountability Office’s (GAO) report titled, “*Identity Theft: Additional Actions Could Help IRS Combat the Large, Evolving Threat of Refund Fraud*” (GAO-14-633/JC451109) recommended that the IRS fully assess the costs and benefits of accelerating W-2 deadlines. We recognize that accelerating the Form W-2 filing deadline would be a significant change to tax administration and that fully assessing the costs and benefits would be helpful. We convened a working group of internal stakeholders and subject matter experts to identify the costs and benefits of accelerating Form W-2 deadlines. The working group will address the current state of IRS systems and work processes and the adjustments or enhancements necessary to meet the objective of using accelerated Form W-2 information. The group will identify and consider the potential impacts on internal and external stakeholders and will identify and evaluate other changes that may be necessary to match Form W-2 data to tax returns prior to issuing refunds.

Ms. Black

1. In February 2014, the U.S. Court of Appeals for the District of Columbia ruled that current statutory law does not give the IRS the authority to regulate tax return preparers. We have seen press reports that in light of this holding, you would favor a “voluntary” system of IRS regulation of return preparers. Since the court held that the IRS does not have the statutory authority to regulate return preparers at all, how would such a “voluntary” system of regulation be consistent with current statutory law?

Response

The IRS continues to believe mandatory testing and continuing education for tax return preparers is necessary for improving the accuracy of return preparation, improved preparer competency and overall tax compliance. For this reason, we are hopeful that the Congress will support the legislative proposal in the President’s FY 2016 budget to explicitly provide the Department of the Treasury and the IRS the authority to regulate all paid return preparers. In the interim, we launched the Annual Filing Season Program (AFSP), a voluntary program designed to encourage uncredentialed tax return preparers to complete continuing education courses to improve their knowledge and understanding of federal tax law relevant to the preparation of federal tax returns. It is important to note that participation in the AFSP is voluntary, not mandatory. An individual may be a paid federal tax return preparer even if the individual does not participate in the AFSP. Return preparers with a valid preparer tax identification number (PTIN) for the 2015 filing season, who complete the required continuing education, including a six hour annual federal tax refresher course, will be issued a “2015 Annual Filing Season Program – Record of Completion.” The IRS has issued more than 40,000 Records of Completion for the 2015 filing season.

2. More recently, in your testimony last month before the Senate Finance Committee, you noted the Administration’s request for legislation providing the return preparer regulatory authority the Court of Appeals rejected. You said the IRS is considering “an interim step” involving a “program of voluntary continuing education.”
 - a. Why do you label this an “interim step”? Do you presume that Congress will eventually agree to expand the IRS’s authority when there have been several recent abuses of its existing authority?

Response

As stated in Revenue Procedure 2014-42, in February 2014, the U.S. Court of Appeals for the District of Columbia in *Loving v. IRS*, 742 F.3d 1013 (D.C. Cir. 2014), held invalid the portion of Circular 230 regulating registered tax return preparers (RTRPs) as practitioners practicing before the IRS. Beginning with its FY 2015 Budget, the Administration has proposed that Congress provide the Treasury Department and the IRS with legislative authority to regulate tax return preparers. In the absence of such legislative authority, the Treasury Department and the IRS have established an Annual Filing Season Program designed to

encourage tax return preparers who are not attorneys, certified public accountants, or enrolled agents to improve their knowledge of federal tax law.

- b. Since continuing education courses are now widely available for return preparers to take as they wish, how would such a “voluntary continuing education” program be a change from what goes on now?

Response

There are preparers who seek out continuing education on a regular basis and are concerned about their own professionalism and require little incentive from the IRS. This is not true of all preparers. The AFSP serves to motivate those who require more structure and encouragement. Additionally, taxpayers have difficulty determining the qualifications of return preparers. As part of the AFSP, during the upcoming filing season, the IRS will launch a look-up tool which for the first time will allow taxpayers to find the credentials of their preparer. This tool will include credentialed preparers and those participating in the AFSP.

Also, applicants for the AFSP must successfully complete an annual federal tax filing season refresher course that is administered by an IRS-approved continuing education provider, a requirement that is not presently in place for return preparers who take continuing education voluntarily. The refresher course must generally cover tax law and filing requirements relevant to Form 1040 series returns and schedules. The refresher course must be six hours and must include a test of the material presented during the course that is given at the end of the course. The test must be a minimum of 100 questions. To successfully complete the refresher course, the applicant must pass the related test by answering 70% of the questions correctly (or a higher percentage if set forth in forms, instructions, or other appropriate guidance).

Certain applicants are not required to take the refresher course as a condition of eligibility to apply for a Record of Completion. They are: attorneys, CPAs, and EAs; individuals who passed the Registered Tax Return Preparer examination; and tax return preparers who are licensed or registered by any state, territory, or possession of the United States, including a Commonwealth, or the District of Columbia after passing an examination covering federal tax matters, and tax return preparers who have passed an examination covering federal tax matters administered by an entity recognized by the IRS as an eligible entity for purposes of this section. Applicants who qualify for this exception must, upon request, present proof of their license, registration, or passage of an approved examination as required by the IRS in forms, instructions, or other appropriate guidance. Applicants required to complete the refresher course must successfully complete 18 hours of continuing education from an IRS-approved continuing education provider during the calendar year prior to the year for which the Record of Completion is sought. The total hours completed must consist of two hours of ethics or professional responsibility, 10 hours of federal tax law topics, and six

hours of federal tax law updates. Applicants who successfully complete the refresher course will have satisfied the requirement to take six hours of federal tax law updates.

Applicants exempt from the refresher course must successfully complete 15 hours of continuing education from an IRS-approved continuing education provider during the calendar year prior to the year for which the Record of Completion is sought. The total hours completed must consist of two hours of ethics or professional responsibility, 10 hours of federal tax law topics, and three hours of federal tax law updates.

3. From which appropriated funds would the IRS cover the costs of administering any voluntary continuing education program? Would the IRS anticipate collecting fees from test takers or continuing education program participants? Would any part of the program provide any other source of non-appropriated revenue to the IRS?

Response

The IRS is not collecting separate fees for participation in the AFSP. Preparers will continue to pay the user fee for their Preparer Tax Identification Number (PTIN) and the costs for the necessary continuing education for this program are paid directly to the continuing education providers. The refresher course, the related comprehension test, and other continuing education requirements are administered by continuing education providers as defined in section 10.9 of Circular 230 and approved by the IRS in accordance with the requirements of Revenue Procedure 2012-12, 2012-2 I.R.B. 275. Continuing education providers report course completion directly to the IRS. The refresher course is not considered successfully completed and providers do not report completion until a preparer has passed the associated comprehension test.

4. Before implementing any voluntary system of IRS regulation of tax return preparers, do you intend to put your proposals out for public comment and hearings? If not, why not?

Response

Participation in the AFSP is voluntary, not mandatory. The AFSP does not impose any requirement on any preparer before they can complete tax returns for compensation. While we did not solicit comments through a formalized process, we did engage the stakeholder community. The Return Preparer Office held individual meetings with five national organizations and seven of the largest employers of tax return preparers to share the proposed AFSP concept and to solicit input. Additional meetings were held with the Commissioner and the Deputy Commissioner for Services and Enforcement at the request of some stakeholder groups. Adjustments were made to final AFSP requirements based on the input and feedback received.